

# 5

# Trust Accounting

Difference Between a General Account and a Trust Account.....	98
Cash Receipts .....	99
Trust Bank Journal.....	101
Trial Balance .....	107
Matter-to-Matter Trust Transfer Journal.....	108
Valuable Property Record.....	109
Practice Audits .....	110
Chapter Summary .....	112
Key Terms .....	112
Further Reading .....	112
Put It into Practice .....	113
Review Questions.....	114
Practice Exercises .....	115

## LEARNING OUTCOMES

After reading this chapter, you should be able to:

- understand the difference between general accounts and trust accounts
- be aware of the record-keeping requirements for trust accounts
- create entries in a trust bank journal
- post from the trust bank journal to the client trust ledgers
- prepare a client trust listing and compare the total with the trust bank balance
- incorporate trust information into the firm's financial statements

Keeping track of transactions affecting the **trust bank account** and maintaining all the trust records required by the Law Society of Upper Canada (LSUC) is like maintaining a parallel set of books for the firm (Figure 5.1). Recording receipts and disbursements promptly and accurately ensures that you are able to meet your client trust obligations as they arise. Your trust records should always be up to date, and you should check clients' trust ledgers periodically to look for unusual or incorrect items. For example, was an amount entered in the wrong client's account?

Required for Trust Bank Account	Required for General Bank Account
Trust bank journal or trust receipts and disbursements journal	General journal or general receipts and disbursements journal
Trust transfer journal (matter-to-matter transfers)	Fees book
	General ledger
Client's trust ledger	Client's general ledger (recommended)
Valuable property record	
Book of duplicate cash receipts	Book of duplicate cash receipts
<b>Trust bank reconciliation</b> with trust listing	Bank reconciliation

FIGURE 5.1 Financial records maintained: trust bank account versus general bank account

Once all the records have been completed, the information will be merged into one set of financial reports showing a balance sheet for the firm in which the information from both the general and trust accounts is consolidated.

## Difference Between a General Account and a Trust Account

In Chapter 1 we discussed the **general bank account** and the mixed trust account. Trust account records are subject to much more scrutiny by the LSUC than general bank account records because these accounts hold money that belongs to clients, not to the firm. Trust records are not required if the firm does not receive any funds in trust for clients.

You will need to use trust accounting in the following situations:

- *When money is received from another party on behalf of a client.* For example, a court case may have been settled in favour of your client, and funds are paid to the firm to be held in trust until your client signs a release and it is delivered to the other party's lawyer.

- *When money is received from a client to be paid to another party.* For example, a court case may have been settled and a client, having lost, brings funds into the firm to pay the judgment to the successful party.
- *When retainers are received from clients to pay for future legal services and future disbursements.* These receipts must be held in the mixed trust account.
- *When payments are made by the firm on behalf of your client.* These can be paid out of the trust account if the client has given a monetary retainer. For example, the client may have authorized the firm to pay a fine from funds held on her behalf in trust.
- *When reimbursement for proper expenses is paid out of the firm's general bank account on behalf of a client.* For example, the firm may have paid to issue a claim but did not have funds in trust for the client. Once the client brings in funds, the amount paid out by the firm from its general bank account can be transferred from trust to the general account to pay for the disbursement(s).
- *For payment on account after a bill has been sent to the client.* Once the client has been billed, funds can be transferred from the trust account to the general bank account to pay the amount owing, but only up to the amount held in trust for that particular client.

## Deposits and Withdrawals from Trust

Bylaw 9, part I, section 1(3) of the LSUC requires that cash, cheques negotiable by the licensee, cheques drawn by the licensee on the licensee's trust account, and credit card sales slips in the possession and control of the licensee are to be deposited in the trust account *no later than the following banking day*.

Trust cheques or bank drafts cannot be made payable to "cash" or "bearer," and cash should never be withdrawn from the trust account, because an audit trail is required. Deposit records kept by the firm must indicate the date on which funds are deposited, the firm's name, the bank account number, the source of each receipt, the name of the client, and the amount of the deposit (see Figure 5.2). Each deposit slip should be stamped by a bank teller. If funds are deposited using an automated teller machine, the ATM receipt needs to be attached to the corresponding deposit slip.

## Cash Receipts

Bylaw 9, part III, section 4(1) contains a provision that a licensee shall not receive or accept from a person, in respect of any one client file, cash in an aggregate amount equal to or exceeding \$7,500 (Canadian).

Exceptions to this requirement are found in section 6 of the bylaw and deal mostly with funds received from public bodies or financial institutions. There is an exception if cash is received from a client for the purpose of paying a fine or penalty. There is also an exception if cash is received for fees, disbursements, expenses, or bail, provided that any refund out of such receipts is also made in cash.

As a minimum additional requirement to maintaining the usual records, a book of duplicate **cash receipts** must be kept with each receipt, identifying the date on which cash is received, the person from whom cash is received, the amount of cash received, the client for whom cash is received, and any file number in respect of which cash is received (see Figure 5.3). The signatures of the licensee or the person authorized by the licensee to receive cash, and of the person from whom cash is received, are also required (bylaw 9, part V, section 19). The receipt book must be kept for a 10-year period pursuant to bylaw 9, part V, section 23(2).

CREDIT ACCOUNT OF:			BUSINESS ACCOUNT DEPOSIT SLIP	
JUSTIN CASE, PARALEGAL			BANK OF MONEY	
IN TRUST			ONTARIO, CANADA	
ACCOUNT NUMBER 232017661				
DATE:			INITIALS:	
DAY 03	MONTH OCT	YEAR 20**	DEPOSITOR'S <i>JC</i>	TELLER'S <i>NM</i>
LIST OF CHEQUES:				
CHEQUE IDENTIFICATION			AMOUNT	
1	HOWES, CLIFF		1,000.00	
2	JONES, FRANK		500.00	
3				
4				
5				
6				
7				
8				
CHEQUE SUBTOTAL			1,500.00	
TOTAL # OF CHEQUES			2	
CASH COUNT:				
JONES 2 X 5				
X 20				
X 20 100.00				
X 50				
X \$1 COIN				
X \$2 COIN				
COIN TOTAL				
CASH COUNT				
CASH SUBTOTAL 100.00				
DEPOSIT:				
CASH SUBTOTAL 100.00				
CHEQUE SUBTOTAL 1,500.00				
DEPOSIT TOTAL \$ 1,600.00				

FIGURE 5.2 Sample trust account deposit slip

DUPLICATE CASH RECEIPT		NUMBER	1001
RECEIVED FROM	Frank Jones	DATE	03/10/20** dd/mm/yr
ON BEHALF OF		FILE NO.	2
AMOUNT	One hundred dollars	DOLLARS	( 100.00 )
Frank Jones Signature of Payor		Justin Case Authorized signature on behalf of firm	
GST/HST REG. NO. RT12345			

FIGURE 5.3 Sample receipt

Remember that money received on behalf of a client for future services or future disbursements must be deposited into the mixed trust bank account. You are also required to track all amounts received and paid out on behalf of clients. A company's balance sheet includes two **trust control accounts**: the trust bank account (moneys received from clients) and the trust funds owed accounts (moneys owed to clients). These trust control accounts provide a total of all moneys received in trust for each client and a total of all moneys owed to each client.

The same double-entry bookkeeping system that applies to general accounting also applies to trust accounting.

## Trust Bank Journal

All the transactions we recorded in previous chapters related to general journal entries. When recording amounts related to trust receipts and disbursements, it is faster and more practical to use a special **trust bank journal**, sometimes called a trust receipts and disbursements journal, in which all financial transactions related to the mixed trust bank account are entered. Keeping trust records in a separate journal helps to eliminate errors and makes it easier to reconcile bank balances at the end of each month. This chapter will teach you how to record transactions in the trust bank journal and how to post the entries to the individual **client ledgers**, also called **“client general ledgers.”** You will also note that trust balances are incorporated into the financial statements for the firm using the two control accounts Trust Bank Account (#115, an asset account) and Trust Funds Owed (#215, a liabilities account). (See the chart of accounts listed on the inside front cover of this textbook.) Some firms prefer to keep two different trust journals, one for trust receipts and one for trust disbursements.

## Book of Original Entry

The trust records to be kept pursuant to the LSUC's bylaw 9, part V, section 18(1) include a book of original entry identifying the following transaction details:

- Each date on which money is received in trust for a client
- The method by which money is received
- The person from whom money is received
- The amount of money received
- The purpose for which money is received
- The client for whom money is received in trust

## Steps in Using the Trust Bank Journal

1. Record the trust bank journal entry (see Examples 1 and 2).
2. Post trust receipts and disbursements to each individual client trust ledger.
3. Prepare the client trust listing (total balance is transferred/posted to Trust Funds Owed).
4. Post the total trust receipts and trust disbursements to the Trust Bank Account ledger (#115) and the Trust Funds Owed ledger (#215).

## Recording Debits and Credits in the Trust Bank Journal

When funds are received by the firm and deposited into the trust bank account, the entry will be recorded as a debit to the account. This is because Trust Bank Account (#115) is an asset account, and assets have a normal debit balance. A credit entry will also be made to the client's trust ledger account to show that the funds are owed to the client. At the end of each period, the total amounts in the client trust ledgers are totalled and the amount is posted to the control account Trust Funds Owed (#215) as a credit because this is a liability account. Trust funds owed to clients must be equal to the amount in the trust bank account. Funds held in the trust account are shown as an asset on the balance sheet. Trust funds owed to clients are shown in the liabilities section of the balance sheet.

The examples that follow show the steps in recording receipts and disbursements in a trust bank journal.

### EXAMPLE 1

#### Recording a Trust Receipt

On October 2, Cliff Howes, client file no. 1, brought Justin Case a retainer in the amount of \$1,000 (in the form of a money order) for a Small Claims Court action against his neighbour, dealing with a dispute over a fence.

##### STEP 1

Enter the date of the receipt.

##### STEP 2

In the Received From/Paid To column, show the amount as "Rec." and enter the name of the person from whom the funds were received.

##### STEP 3

Under Client/Description, indicate the client file name and the reason the funds were received.

##### STEP 4

In the Method of Payment column, indicate how the client paid—via a money order, cheque, credit card, or other means.

##### STEP 5

In the Dr. column, enter \$1,000 because funds were received and had to be deposited into the trust bank account. Trust Bank Account (#115) is an asset account, so it is debited to indicate an increase in the account.

##### STEP 6

Post the amount of \$1,000 to the client's trust ledger sheet by entering the amount in the Receipts (Cr.) column in the Cliff Howes file no. 1 ledger sheet (Figure 5.5). Show that the amount was posted by filling in the file number in the File No. column of the journal.

Justin Case, Paralegal Trust Bank Journal						TJ1
Date 20**	Received From/Paid To	File No.	Client/Description	Method of Payment	Trust Bank Account	
					Dr.	Cr.
Oct. 2	Rec. Cliff Howes	1	Cliff Howes/Retainer	Money Order	1,000	

## EXAMPLE 2

### Recording a Trust Disbursement

On October 3, Justin wrote a cheque on the Cliff Howes file to Deliveries Inc. to pay the amount of \$20 to send a demand letter by courier to Howes' neighbour.

#### STEP 1

Enter the date of the cheque.

#### STEP 2

In the Received From/Paid To column, show the amount as "Pd." and enter the name of the company to which the funds were paid.

#### STEP 3

Under Client/Description, indicate the name of the client and the reason the funds were paid out.

#### STEP 4

In the Method of Payment column, indicate the trust cheque number used to pay the bill.

#### STEP 5

Leave the Dr. column blank.

#### STEP 6

In the Cr. column, enter the amount of \$20 paid out of the trust account.

Justin Case, Paralegal Trust Bank Journal						TJ1	
Date 20**		Received From/Paid To	File No.	Client/Description	Method of Payment	Trust Bank Account	
Oct.	2	Rec. Cliff Howes	1	Cliff Howes/Retainer	Money Order	Dr.	Cr.
	3	Pd. Deliveries Inc.	1	Cliff Howes/Courier	Chq. 1		20

Follow the same steps as in the examples above for the transactions that took place from October 5 to the end of the period. Figure 5.4 shows the trust bank journal entries for October once the totals have been posted to the client trust ledgers. Posting from the trust bank journal is discussed in the following section.

Transactions
On October 5, Frank Jones, client file no. 2, paid Justin a retainer in the amount of \$600 using his credit card and cash for defence of charges under the <i>Highway Traffic Act</i> .
On October 15, Justin received a bank draft in the amount of \$2,500 from the neighbour's firm, James Settlor, in full settlement of the claim made by Cliff Howes.
On October 16, the funds received in settlement were paid to Cliff Howes.
On October 20, Justin represented Frank Jones in court and negotiated a reduced fine of \$300. He paid the Minister of Finance the amount of the fine from trust funds held on behalf of the client.

Justin Case, Paralegal Trust Bank Journal						TJ1	
Date 20**		Received From/Paid To	File No.	Client/Description	Method of Payment	Trust Bank Account	
						Dr.	Cr.
Oct.	2	Rec. Cliff Howes	1	Cliff Howes/Retainer	Money Order	\$1,000	
	3	Pd. Deliveries Inc.	1	Cliff Howes/Courier	Chq. 1		20
	5	Rec. Frank Jones	2	Frank Jones/Retainer	Credit Card 500 Cash 100	600	
	15	Rec. James Settlor	1	Cliff Howes/Settlement	Bank Draft	2,500	
	16	Pd. Cliff Howes	1	Cliff Howes/Settlement	Chq. 2		2,500
	20	Pd. Minister of Finance	2	Jones/Payment of Fine	Chq. 3		300
	31				Totals	\$4,100	\$2,820
						(115/215)	(115/215)

FIGURE 5.4 Trust bank journal entries for October (after posting)

## Posting from the Trust Bank Journal

Now that you have entered all the transactions for the month of October, total the columns in the trust bank journal. Post the totals from the trust bank account Dr. and Cr. columns to the general ledger for the firm (Trust Bank Account #115). Post the individual amounts to each client trust ledger sheet.

The figures in the File No. column indicate that the individual amounts were posted to each client's trust ledger sheet. This should be done on a daily basis when the entries are recorded in the journal.

The numbers at the bottom of the trust bank account Dr. and Cr. columns (115/215) in Figure 5.4 indicate that the total deposits and cheques made to the trust account were posted to the general ledger.

The client trust ledgers in Figure 5.5 show how the information was posted from the trust bank journal to the client trust ledger accounts. Note that a running total of the balance in the client's trust ledger account was calculated after each transaction. In this way, you always know how much money each client has to his or her credit in the mixed trust bank account.

Although there is only one entry for each date in the trust bank journal, Figure 5.5 shows that double entries have been made. Each amount in the trust bank journal is transferred to the individual client ledger accounts in the client trust ledger. These transactions are posted on a daily basis.

Justin Case, Paralegal Client Trust Ledgers				
Account: HOWES, Cliff re Small Claims Court				File No. 001
			Client Trust Ledger	
Date 20**	Received From/Paid To Explanation	Disbursements (Dr.)	Receipts (Cr.)	Balance in Trust
Oct. 2	Retainer		1,000	1,000
3	Deliveries Inc.	20		980
15	James Settlor, Settlement		2,500	3,480
16	Cliff Howes, Settlement Funds	2,500		980

  

Account: JONES, Frank re Highway Traffic Act				File No. 002
			Client Trust Ledger	
Date 20**	Received From/Paid To Explanation	Disbursements (Dr.)	Receipts (Cr.)	Balance in Trust
Oct. 5	Retainer		600	600
20	Minister of Finance, Fine	300		300

FIGURE 5.5 Client trust ledgers after posting

Some general principles about posting from the trust bank journal:

1. The individual amounts in the Dr. column of the trust bank journal are posted to the Receipts (Cr.) column in the client's trust ledger on a daily basis. Thus you have a debit entry and a credit entry, which balance your books. Each client ledger sheet is kept up to date at all times as posting is done daily and a running total is calculated. The client file number is entered in the trust bank journal to show the client trust account to which the entry was posted.

Trust Bank Account Dr. = Client Trust Ledger Sheet Cr.

2. The individual amounts in the Cr. column of the trust bank journal are posted to the Disbursements (Dr.) column in the client's trust ledger on a daily basis, and the file number is entered in the trust bank journal to show that the entry has been posted. Again you have a double entry—a credit entry reducing the balance in the bank account and a debit entry in the respective client's trust ledger sheet.

Trust Bank Account Cr. = Client Trust Ledger Sheet Dr.

3. The totals of the trust bank account debit and credit columns are posted to the trust bank account in the general ledger. This is usually done at the end of the month.
4. A list of balances owed to clients, called the client trust listing, is prepared showing the total amounts held by each client. This information is obtained from the individual client trust ledger accounts (Figures 5.5 and 5.6). This total amount is entered in the general ledger account Trust Funds Owed (#215). The balance in this account must be equal to the balance in the Trust Bank Account (#115) (Figure 5.7).

Trust Bank Account Balance = Total of Client Trust Listing  
(#115) (#215)

## Proving That Debits Equal Credits

To prove that there are no errors in the trust bank journal after posting, check to make sure that the balance in the general ledger account Trust Bank Account (#115) is the same as the total of the list of balances owed to clients prepared at the end of the period.

**Justin Case, Paralegal**  
**List of Balances Owed to Clients**  
**October 31, 20\*\***

<i>File No.</i>	<i>Account</i>	<i>Balance Owed</i>
1	HOWES, Cliff re Small Claims Court	\$980
2	JONES, Frank re Highway Traffic Act	300
	Total Owed to Clients	\$1,280

FIGURE 5.6 Client trust listing at October 31

The total amount in the client trust listing as of October 31 is \$1,280, with the individual amounts shown in Figure 5.6. After posting to the general ledger, the balance in Trust Bank Account (#115) is \$1,280. This serves as proof that the amounts in the client ledgers are equal to the amount in the bank.

Trust Bank Account					Account No. 115		
Date 20**		Explanation	PR	Debit	Credit	Dr./Cr.	Balance
Oct.	31	Trust Totals for October	TJ1	4,100	2,820	Dr.	1,280

Trust Funds Owed					Account No. 215		
Date 20**		Explanation	PR	Debit	Credit	Dr./Cr.	Balance
Oct.	31	Trust Funds Owed to Clients	✓	4,100	2,820	Cr.	1,280

FIGURE 5.7 General ledger, trust bank account at October 31

## Possible Error

An error to watch for when comparing the client trust listing with the trust bank account balance is whether an amount was accidentally posted to the wrong client ledger. The total client trust listing and the bank balance might be equal, but the amount debited or credited to an individual client could be incorrect.

## Trial Balance

A **trial balance** of the general ledger accounts after the trust posting is completed would be as shown in Figure 5.8.

<b>Justin Case, Paralegal</b>			
<b>Trial Balance</b>			
<b>October 31, 20**</b>			
#	<i>Account</i>	<i>Debit</i>	<i>Credit</i>
100	General Bank Account	\$7,100	
115	Trust Bank Account	1,280	
155	Computer Equipment (Hardware)	900	
158	Office Furniture and Equipment	2,250	
200	Accounts Payable/General Liabilities		\$580
205	Personal Loan		4,000
210	Credit Card Debt		1,500
215	Trust Funds Owed		1,280
300	Justin Case, Capital		2,550
400	Fees Earned		3,000
535	Office Supplies/General Expense	580	
538	Rent Expense	500	
565	Telephone Expense	300	
		<u><u>\$12,910</u></u>	<u><u>\$12,910</u></u>

FIGURE 5.8 Trial balance including Trust Bank Account and Trust Funds Owed

Because the only changes made were to the trust bank account and trust funds owed to clients, this will have no effect on the firm's income statement or on the statement of owner's equity for the month of October, so these statements are not reproduced here. However, the balance sheet would show the trust bank account and the trust funds owed as in Figure 5.9.

The LSUC requires licensees to maintain a record showing a comparison made monthly of the total balances held in the trust account or accounts and the total of all unexpended balances of funds held in trust for clients as they appear from the financial records. An explanation must be provided giving the reasons for any differences between the totals in the client ledger and the reconciled bank balance (bylaw 9, part V, section 18(8)). This point will be discussed in greater detail when bank reconciliations are covered in Chapter 9.

Justin Case, Paralegal Balance Sheet October 31, 20**		
Assets	Liabilities	
General Bank Account	\$7,100	Accounts Payable/General Liabilities
Trust Bank Account	1,280	Credit Card Debt
Computer Equipment (Hardware)	900	Trust Funds
Office Furniture and Equipment	<u>2,250</u>	Personal Loan
		Total Liabilities
Total Assets	<u>\$11,530</u>	<u>\$7,360</u>
		Owner's Equity
		J. Case, Capital
		Total Liabilities and Owner's Equity
		<u>\$11,530</u>

FIGURE 5.9 Balance sheet including trust assets and trust liabilities

## Matter-to-Matter Trust Transfer Journal

Whenever trust funds are moved from one client's trust ledger account to another client's trust ledger account, the transfer must be recorded and the reason for the transfer must be explained (bylaw 9, part IV, section 9(1)(4) and part V, section 18(4)). The **special journal** used to record these transactions is called the trust transfer journal.

Sometimes a client may instruct the firm to transfer funds held in trust on his or her behalf over to another file. This situation might arise if a parent has a file with the firm and a child is charged with an offence. The parent assumes responsibility for the child's defence and instructs the paralegal to use money held in trust in the parent's account to cover the cost.

### EXAMPLE 3

On November 1, Cliff Howes, client file no. 1, has \$980 left in his trust account after receiving the settlement paid in his court case. Also on November 1, he instructs the firm to transfer \$280 to a new file in the name of Larry Howes as a retainer to cover legal fees in defending his son's shoplifting case.

This transaction must be recorded in a matter-to-matter trust transfer journal showing that money was moved from one client to another:

Justin Case, Paralegal Trust Transfer Journal						
Date 20**		Received From/Paid To Reason for Transfer	File No.	Client	Allocated Amount	Transfer Amount
Nov.	1	Cliff Howes	1	Cliff Howes	-280	
	1	Larry Howes	3	Larry Howes	280	280
		To transfer funds to account of Larry Howes				

Clients' instructions should be obtained before transferring funds from one matter to another matter if the two matters are for the same client. If the transfer is made from one client to another client, these instructions should be obtained in writing prior to any transfer being made.

A new client ledger would have to be opened for the Larry Howes file, and the transfer would be posted in the client ledgers as follows:

Justin Case, Paralegal Client Trust Ledgers				
Account: HOWES, Cliff re Small Claims Court				File No. 001
Date 20**	Received From/Paid To Explanation	Disbursements (Dr.)	Receipts (Cr.)	Balance in Trust
Oct. 2	Retainer		1,000	1,000
3	Deliveries Inc.	20		980
15	James Settlor, Settlement		2,500	3,480
16	Cliff Howes, Settlement Funds	2,500		980
Nov. 1	Cliff Howes, Transfer to File No. 3	280		700

  

Account: HOWES, Larry				File No. 003
Date 20**	Received From/Paid To Explanation	Disbursements (Dr.)	Receipts (Cr.)	Balance in Trust
Nov. 1	Transfer from Cliff Howes		280	280

Note that the total balance in the trust bank account has not been affected by this transaction, because funds were moved only between two client trust ledger accounts. No cheque needs to be written to complete this transaction; however, the transfer must be shown in the firm's records.

The client list of trust funds owed to clients will reflect this transaction at the end of November when the trust listing is prepared.

## Valuable Property Record

Another trust record required by the LSUC is the **valuable property record** (bylaw 9, part V, section 18(9)). The record is used to record all property, other than money, held in trust for clients, and describes each item and identifies the date on which the licensee took possession, the person who had possession immediately before the licensee took possession, the value, the client for whom each item is held in trust, the date on which possession is given away, and the person to whom the item is given.

Valuable property can be anything of value held for clients, such as bond certificates, share certificates, jewellery, or collector's items. Anything that a paralegal could convert to cash on his or her own authority should be included. It would be wise to investigate any insurance implications before agreeing to hold valuable property for clients. And you would certainly need to have written instructions from everyone before getting involved in such a situation.

The valuable property record is not used to record any trust moneys because these must be shown in the financial accounting records. Items such as term deposits and bank accounts held at a financial institution must be reported in the financial records, not in the valuable property record. Pursuant to bylaw 9, sections 18(9) and 23, the valuable property record must be kept for ten years plus the current year.

Although holding a client's valuable property does not typically fall within a paralegal's role, the following scenario is not an impossible one.

## EXAMPLE 4

On October 20, Frank Jones brought a stamp collection in to the firm for safekeeping. This collection is still held by the firm. On November 1, Larry's parents made him turn over his hockey cards to Justin Case to ensure their son helped pay for his legal fees for the shoplifting charge. The parents insisted that if Larry did not work to contribute to his legal costs, Justin Case would be authorized to sell the cards and apply the proceeds to Larry's legal fees. Justin sold the cards on December 15 because Larry did not come up with the money as required. The proceeds from the sale would be deposited in the trust bank account to the credit of Larry Howes.

Justin Case, Paralegal Valuable Property Record						
Client	Description of Property	Date Received	Received From	Value of Property	Given To	Date Given
Jones, Frank	Stamp Collection	Oct. 20, 20**	Jones, Frank	200		
Howes, Larry	Hockey Cards	Nov. 1, 20**	Howes, Larry	60	Joe's Pawn Shop	Dec. 15, 20**

## Practice Audits

Section 49.2 of the *Law Society Act* authorizes spot audits of members with a view to ensuring that licencees engage in proper management practices. Audits include an assessment of financial record-keeping practices to ensure compliance with bylaw 9. The primary goal of audits is to provide on-site guidance aimed at helping the licensee correct minor deficiencies with respect to record keeping, and to address any deficiencies that could adversely affect service to clients. Where misconduct is found, reviewers are required to report that misconduct pursuant to rule 6.10(3) of the *Rules of Professional Conduct*. Failure to meet minimum standards can result in suspension of membership until the LSUC is satisfied that the licensee is meeting the minimum standards of professional competence. It is usual to receive a two-week advance notice of a spot audit. If members try to defer or cancel audit appointments, they will be required to fax a copy of the most recent trust bank reconciliation to the auditor. Failure to do so may result in an immediate unannounced visit.

## TAX TIP

## Applying GST/HST to Client Accounts

Rule 8.01(2) of the Law Society of Upper Canada's *Paralegal Rules of Conduct* requires licensees to meet promptly all financial obligations incurred in the course of practice. One responsibility is to collect and remit HST to the Canada Revenue Agency (CRA). Licensees must confirm how GST/HST applies to the specific legal services and disbursements they provide. They should consult with an accounting or tax professional to discuss how to implement HST properly within their internal accounting and invoicing systems.

The CRA has published a policy to deal with GST/HST on disbursements, which would also apply to paralegals. Its GST/HST Policy Statement P-209R is found at <http://www.cra-arc.gc.ca/E/pub/gl/p-209r/README.html>. This policy expands on the obligation to pay GST/HST on disbursements paid on behalf of clients. The disbursements described in this policy statement are characterized as either "incurred as agent" or "not incurred as agent."

The phrase "incurred as agent" indicates that the disbursement described is generally incurred in a lawyer's capacity as agent for a particular client. As such, no GST/HST is eligible (able to be charged) on the subsequent reimbursement by the client. The phrase "not

incurred as agent" indicates that the disbursement described is generally incurred otherwise than in a lawyer's capacity as agent for a particular client, so GST/HST is eligible on the subsequent reimbursement by the client.

For example, in the area of civil litigation practice, common disbursements considered to be incurred as agent are court fees to start a legal proceeding, motion fees, court filing fees, or notice of trial fees. Because these fees are deemed by the CRA to be incurred as agent for a particular client, GST/HST is not charged on the disbursements when the client is invoiced.

However, in civil litigation practice, payment of witness fees, fees for recording services, transcript production or special examiner fees, service of document fees, and fees paid to have an expert prepare a report in respect of a particular proceeding or to have the expert appear at trial are subject to GST/HST because they are considered "not incurred as agent."

The CRA considers disbursements not incurred as agent to include such items as payment made for telephone charges, photocopy charges, courier costs, costs for travel by the licensee, and postage. GST/HST is charged on these amounts even though GST/HST may have been charged on the original invoice to the firm.

## CHAPTER SUMMARY

There are some similarities between trust accounting and general accounting: each has books of original entry and ledgers, and the double-entry bookkeeping system applies to both types of accounting. Trust accounting requires some additional records, whereas general accounting will incorporate information from the trust records into the financial statements for the firm. Most trust records must be maintained for a period of 10 years plus the current year, whereas general records are required to be maintained for the most recent 6 full years plus the current year. See Chapter 9 for more discussion of this. All bank accounts, whether trust or general, must be reconciled at the end of each month.

In keeping with the LSUC's mandate to protect the interests of the public, licensees must be vigilant in ensuring that the obligations set out by the *Law Society Act* and its bylaws and the *Rules of Professional Conduct* are followed. The Law Society regularly conducts spot audits on members, and mishandling of trust funds can result in discipline or losing one's licence. If you purchase accounting software for a firm, it is wise to ensure that the system purchased can handle trust transactions and properly record transactions in a client ledger.

## KEY TERMS

- cash receipts, 99
- client general ledgers, 101
- client ledgers, 101
- general bank account, 98
- special journal, 108
- trial balance, 107
- trust bank account, 98
- trust bank journal, 101
- trust bank reconciliation, 98
- trust control accounts, 101
- valuable property record, 109

## FURTHER READING

Law Society of Upper Canada, By-Laws. "By-law 9—Financial Transactions and Records," online: <<http://www.lsuc.on.ca/by-laws/>>. (See also the Appendix of this textbook.)

Law Society of Upper Canada, *Paralegal Rules of Conduct and Paralegal Professional Conduct Guidelines*, online: <<http://www.lsuc.on.ca/paralegal-conduct-rules/>>.

Law Society of Upper Canada, *The Bookkeeping Guide for Paralegals* (Toronto: LSUC, February 2014), online: <[http://www.lsuc.on.ca/uploadedFiles/PDC/Practice\\_Review/Paralegal%20Bookkeeping%20Guide%20-%20February%202014.pdf](http://www.lsuc.on.ca/uploadedFiles/PDC/Practice_Review/Paralegal%20Bookkeeping%20Guide%20-%20February%202014.pdf)>. (See General Receipts Journal and General Disbursements Journal.)

## PUT IT INTO PRACTICE

### Case Example: LSUC Rules

Ann Litigate operates a paralegal firm, operating under the name Ann Litigate Paralegal Services, and employs a part-time secretary. Ann works as a sole practitioner and deals with all professional, business, and administrative matters of the firm. For example, Ann does all the banking to ensure that she has control over her general and trust bank accounts in accordance with the rules and regulations of the Law Society of Upper Canada, and she does all the bookkeeping.

Ann is concerned about her record-keeping responsibilities because she is so busy with the day-to-day operations of the business as well as meeting deadlines and client expectations. Although Ann keeps all her source documents, she sometimes waits until the end of the month to complete the various journals and ledgers pursuant to section 18 of the LSUC's bylaw 9, and then she becomes overwhelmed. What best-practice strategies or tools can Ann use to meet all of her obligations? Discuss.

## REVIEW QUESTIONS

### Short Answer

Give a full answer for each question:

1. A client bill is paid in part by trust moneys held on behalf of the client and in part by cheque. How will the paralegal record this transaction?
2. If a client has two separate matters being handled by a paralegal, can that client authorize the transfer of funds from one trust account to the other? Explain. What if the transfer of funds is from a third-party trust account? Explain.
3. When would a paralegal use a book of duplicate cash receipts? For how long would this record have to be maintained?
4. How are monetary retainers recorded? Identify the appropriate journal and/or ledger.
5. How can you verify that the trial balance after the trust posting is correct?
6. Why is it important to review client ledgers from time to time?
7. Which journal is used to track payments made from the trust bank account?
8. A client entrusts to a paralegal her certificate of authenticity of a vintage coin collection that is the subject of a small claims dispute. How would the paralegal record and track this item?

## PRACTICE EXERCISES

### Practice Exercise 5.1

Ann Litigate had the following trust transactions in the month of June:

#	Date 20**	Transaction	Amount
1	June 1	Ann received a cheque (#91) from a new client, Jessica Palmer, as a retainer deposit in an immigration law matter.	\$2,500
2	June 1	Ann wrote trust cheque #352 on the trust bank account in payment of invoice #518 previously sent to Karen Charles. Assume that on May 30, Charles had a balance of \$4,500.	\$4,000
3	June 8	There is an amount of \$60 charged to Daniel Pitt for photocopy charges incurred in the preparation of a document brief for use at an upcoming criminal trial. Invoice #519 was sent to Daniel Pitt, and Ann wishes to recover the charges for the disbursement from trust (trust cheque #353). Assume that on May 30, Pitt had a balance of \$1,000.	\$60
4	June 25	Louise Forte sent cheque #47 written on her personal bank account to the firm in the amount of \$3,130. Ann deposited the cheque into the trust bank account and then wrote trust cheque #354 in payment of invoice #520 for \$1,130 and held the balance remaining in trust as a retainer.	\$3,130

Review the sample worksheet below and then, using the worksheets provided:

- Prepare the appropriate trust bank journal entries to record the transactions shown above.
- Post the entries to the client trust ledgers.
- Post the totals to the appropriate general ledger accounts.
- Complete the client trust listing at the end of the month. Does the listing match the amount in account #215 (Trust Funds Owed)?

## Sample worksheets

On June 18, Paralegal receives \$1,500 as a retainer from a new client, Anthony Johnston.

Ann Litigate, Paralegal Trust Bank Journal						TJ1
Date 20**		Received From/ Paid To	File No.	Client/Description	Method of Payment	Trust Bank Account
June	18	Rec. Anthony Johnston	01	Johnston, retainer	Cheque	1,500
	31				Totals	<u>1,500</u> <u>0</u>
						(115) (115)

Sample client ledger after posting

Ann Litigate, Paralegal  
Client Trust Ledgers

Account: JOHNSTON, Anthony			File No. 06	
			Client Trust Ledger	
Date 20**		Received From/Paid To Explanation	Disbursements (Dr.)	Receipts (Cr.)
June	18	Retainer		1,500
				1,500

## Worksheet a:

Ann Litigate, Paralegal Trust Bank Journal					TJ1	
Date 20**	Received From/ Paid To	File No.	Client/Description	Method of Payment	Trust Bank Account	
					Dr.	Cr.
Totals						

## Worksheet b:

Ann Litigate, Paralegal Client Trust Ledgers				
Account:	Client Trust Ledger			File No.
Date 20**	Received From/Paid To Explanation	Disbursements (Dr.)	Receipts (Cr.)	Balance in Trust

## Worksheet c:

Ann Litigate, Paralegal General Ledger Accounts							
Trust Bank Account						Account No. 115	
Date 20**	Explanation		PR	Debit	Credit	Dr./Cr.	Balance
May 30	Opening balance						5,500

  

Trust Funds Owed						Account No. 215	
Date 20**	Explanation		PR	Debit	Credit	Dr./Cr.	Balance
June 30	Total from client listing						

## Worksheet d:

Ann Litigate, Paralegal List of Balances Owed to Clients June 30, 20**		
File No.	Account	Balance Owed
06	PALMER, J. re Immigration	
04	CHARLES, K.	
03	PITT, D.	
08	FORTE, L.	
	Total Owed to Clients	=====